

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
LEWIS AND BEVERLY HYMAN)

For Appellants: Marvin L. Blankstein
Certified Public Accountant

For Respondent: Bruce W. Walker
Chief Counsel

Paul 3. Petrozzi
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Lewis and Beverly Hyman against a proposed assessment of additional personal income tax in the amount of \$14,184.40 and a penalty in the amount of \$3,546.10 for the year 1972.

Appeal of Lewis and Beverly Hyman

Beverly Hyman is included as an appellant apparently only because a joint tax return was filed. "Appellant" herein refers to Lewis Hyman.

The issues presented by this appeal are whether or not the family trust created by appellant is a "grantor trust," making losses incurred by the trust deductible by appellants in the computation of their personal income tax and, if so, whether or not appellants are entitled to deduct the full amount claimed.

In September 1972, appellant executed a document creating the Hyman Family Trust. The trust is irrevocable by its terms. The trustee is an individual, described by appellant as a nonadverse party. Appellant, as grantor, made an initial irrevocable gift to the trust of \$20,000. Sometime later in that same year, the trust contributed \$50,000 for a 9.7 percent limited partnership interest in Lioness Service Company (Lioness), a motion picture film production organization. Lioness incurred a substantial loss in 1972, \$141,843.94 of the loss being attributable to the partnership interest owned by the trust.

Appellants claimed the entire \$141,843.94 loss as a deduction from their personal income in taxable year 1972. Respondent disallowed the deduction and issued a notice of proposed assessment (NPA). Appellants protested, respondent affirmed the NPA, and this timely appeal followed. The 25 percent penalty imposed for failure to provide information has been abated by respondent, since some of the information requested was eventually received.

Revenue and Taxation Code section 17781 provides that when a grantor is treated as the owner of any portion of a trust, income and deductions attributable to that portion of the trust are included in computing the personal income tax of the grantor. (A trust where a grantor is so treated is referred to herein as a "grantor trust.") A grantor is treated as the owner of a trust when the grantor, or a nonadverse party, may dispose of the beneficial enjoyment of corpus or income without the consent or approval of an adverse party. (Rev. & Tax. Code, § 17784.) However, the grantor is not treated as the owner of the trust where specified powers are held by certain persons. (Rev. & Tax. Code, §§ 17785-17787.) One of these exceptions to section 17784 is found in Revenue and Taxation Code section 17786, which provides:

Appeal of Lewis and Beverly Hyman

Section 17784 shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustee^s, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor--

(a) To distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries: or

(b) To pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries).

A power does not fall within the powers described in this section if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the **income** or corpus, except where **such action is' to provide for after-born or after-adopted children.**

If the trustee is a person described in the above section and may exercise the powers described in parts (a) and (b) of that section, the trust is not a grantor trust. If any person may add beneficiaries to the trust, however, section 17786 does not apply and the trust will be a grantor trust.

The trust agreement executed by appellant establishes, in Article I, the trust designated as the Hyman Family Trust, the beneficiaries of which are "all of the descendants of the Grantor living from time to time and at any time." Sections 3.1 and 3.2 of Article III empower the trustee to distribute all or as much of the income and principal to any one or more of the trust beneficiaries "as the Trustee **deems to be** in the best interests of said beneficiaries." Section 3.4 provides for division and distribution of the trust upon the grantor's death, each share to be held as a "descendant's" or "separate" trust. The succeeding articles provide for the distribution and administration of the separate trusts. The final one, Article XIII, allows the trustee "of each separate trust" to add as beneficiaries "of any separate trust" any of the grantor's descendants living at the date of the execution of

Appeal of Lewis and Beverly Hyman

the trust agreement, after-born or after-adopted descendants of the grantor, and one or more qualified charitable organizations.

Appellant contends that since the trustee, a nonadverse party, has the powers set forth in section 17784, the trust is a grantor trust. Further, appellant argues that the trustee's power in Article XIII to add beneficiaries makes the exception-creating sections, such as 17786, inapplicable. This leaves section 17784 effective, resulting in a grantor trust and allowing appellants to take the trust's deduction on their personal income tax return.

Respondent concedes that the trustee's powers are those described in section 17784, but contends that section 17786 makes the trust a non-grantor trust, in spite of the power to add beneficiaries. This, it is argued, is because the power to add **beneficiaries** does not refer to the Hyman Family Trust under consideration **here**, but rather to the separate trusts which come into existence, if at all, only after the grantor's death.

In order for the exception of section 17786 to apply, the trustee must be someone other than the grantor who is not a "related or subordinate" party subservient to the grantor's wishes. A related or **subordinate party is a nonadverse party who is also the grantor's** spouse, parent, sibling, issue or a specified employee of the grantor or his corporation. (Rev. & Tax. Code, § 17782, subd. (c).)

The trust instrument makes clear that the trustee is not the grantor. Appellant states only that the trustee is a nonadverse party, but respondent apparently determined that the trustee is not a related or subordinate party. Appellant, who bears the burden of proving respondent's determination incorrect, has presented no evidence to contradict that classification. Consequently, we **find that** the trustee of the **Hyman** Family Trust falls within the classification of trustees which makes section 17786 applicable. There is no question that the trustee has the powers described in both parts (a) and (b) of section 17786.

It thus appears that the Hyman Family Trust meets the requirements of section 17786, precluding treatment as a grantor trust unless a power to add beneficiaries **renders** that section inapplicable. Article XIII of the **trust instrument** empowers the trustee

Appeal of Lewis and Beverly Hyman

to add any of three classes of beneficiaries, but this power is specifically limited to any "separate trust." As previously noted, "separate trusts" refers to those **descendents'** trusts which may be created upon the grantor's death. Since this power does not affect the Hyman Family Trust, it does not prevent the application of section 17786. Therefore, we find that the Hyman Family Trust is not a grantor trust.

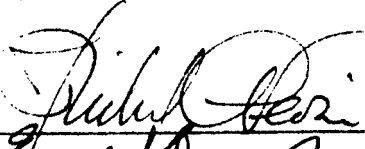
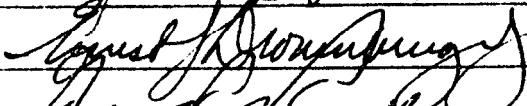
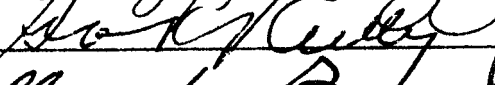
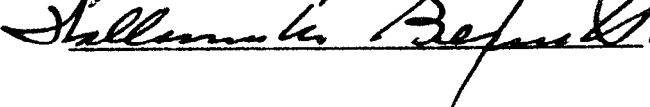
Having found that the trust is not a grantor' trust, it is not necessary to decide the remaining issue. Respondent's action is therefore sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Lewis and Beverly Hyman against a proposed assessment of additional personal income tax in the amount of \$14,184.40, and a penalty in the amount of \$3,546.10 for the year 1972, is hereby modified to reflect the abatement by the Franchise Tax Board of the penalty amount. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 30th day of September, 1980, by the State Board of Equalization.


_____, Chairman

_____, Member

_____, Member

_____, Member
_____, Member